82-539

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No._____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

FIBERGLASS SPECIALTY COMPANY, INC.,
Petitioner,

v.

BOR-SON CONSTRUCTION, INC.,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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224-7631 — Review Publishing Co., 257 E. 6th St., St. Paul, Minn. 55101 — 224-7631

QUESTION PRESENTED

Whether the Court of Appeals may overturn a decision on the ground that the Bankruptcy Court lacked summary jurisdiction of the case, where neither party has raised the issue.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

HISTORY OF THE CASE

The District Court of the United States, District of Minnesota, Third Division in Bankruptcy, No. 3-78-367(D)—Verdict for Fiberglass Specialty Company, Inc.

The United States District Court, District of Minnesota, Fourth Division, No. 4-80-315—Affirmed.

The United States Court of Appeals for the Eighth Circuit, No. 81-1647—Reversed and Remanded to the District with direction to Vacate the Order of the Bankruptcy Court for lack of jurisdiction.

STATEMENT OF JURISDICTION

Judgment entered by the Eighth Circuit Court of Appeals—May 19, 1982.

Re-hearing denied—June 21, 1981.

This Petition is submitted pursuant to the jurisdiction of the Supreme Court under 29 U.S.C. §1254.

APPLICABLE STATUTES AND RULES

11 U.S.C. §46 (Bankruptcy Act §23)

Jurisdiction of United States and State Courts . . . . b. Suits by the receiver and the trustee shall be brought or prosecuted only in the courts where the bankrupt might have brought or prosecuted them if proceedings under this Act had not been instituted, unless by consent of the defendant, except as provided in sections 60, 67, and 70 of this Act.

Fed. R. Civ. P. 12(g)

Consolidation of Defenses in Motion. A party who makes a motion under this rule may join with it any other motions herein provided for and then available to him. If a party makes a motion under this rule but omits therefrom any defense or objection then available to him which this rule permits to be raised by motion, he shall not thereafter make a motion based on the defense or objection so omitted, except a motion as provided in subdivision (h)(2) hereof on any of the grounds there stated.

Bankruptcy Rule §2

Creation of Courts of Bankruptcy and Their Jurisdiction. a. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

. . . . (7) Cause the estates of bankrupts to be collected, reduced to money, and distributed, and determine controversies in relation thereto, except as herein otherwise provided, and determine and liquidate all inchoate or vested interests of the bankrupt's spouse in the property of any estate whenever, under the applicable laws of the State, creditors are empowered to compel such spouse to accept a money satisfaction for such interest; and where in a controversy arising in a proceeding under this Act an adverse party does not interpose objection to the summary jurisdiction of the court of bankruptcy, by answer or motion filed before the expiration of the time prescribed by law or rule of court or fixed or extended by order of court for the filing of an answer to the petition, motion or other pleading to which he is adverse, he shall be deemed to have consented to such jurisdiction.

Bankruptcy Rule 915

Objection to Jurisdiction of Court of Bankruptcy

(a) Waiver of Objection to Jurisdiction. Except as provided in Rule 112 and subject to rule 928, a party waives objection to jurisdiction of an adversary proceeding or a contested matter and thereby consents to such jurisdiction if he does not make objection by a timely motion or answer, whichever is first served.

STATEMENT OF THE CASE

STATEMENT OF THE FACTS

On August 11, 1975, Bor-Son Construction, Inc. (hereinafter referred to as "Bor-Son") hired Fiberglass Specialty Company, Inc. (hereinafter referred to as "Fiberglass") to design, manufacture, and install circular tank covers for the Estherville, Iowa Water Treatment Facility (hereinafter referred to as "the Estherville Project"). Fiberglass distributed most of its work among several subcontractors.

When Fiberglass completed its work on the Estherville Project in November of 1977, Bor-Son was indebted to Fiberglass for $66,191.31. Bor-Son refused to pay its debt until Fiberglass supplied lien waivers from all subcontractors who worked on the Estherville Project. Four subcontractors refused to sign waivers, and Bor-Son continued to withhold the final payment.

On March 28, 1978, Fiberglass filed for an Arrangement under Chapter XI of Bankruptcy Act. On April 3, 1978, the Bankruptcy Court entered its order authorizing Fiberglass to remain in possession of its properties, business, and affairs, and enjoining and restraining all persons from proceeding against it or any of its properties until further order by the Court (Appendix, p. A-1). On May 18, 1978, Fiberglass contacted Bor-Son by letter, demanding payment for its work on the Estherville Project and informing Bor-Son of the pending Chapter XI proceedings. In a letter dated August 4, 1978, Fiberglass informed the Estherville City Council of the Chapter XI proceedings and of the necessity that all monies due Fiberglass and its subcontractors be paid into the Bankruptcy Court. A copy of this letter was sent to and received by Bor-Son. On September 18, 1978, Fiberglass commenced

an action in Bankruptcy Court to recover the $66,191.81 retained by Bor-Son. Bor-Son answered the Summons and Complaint and filed a counterclaim. Bor-Son subsequently paid off all the claimants who had filed liens against the Estherville Project, a total amount of $62,112.72; this payment was made without the permission of the Bankruptcy Court and without the consent of Fiberglass. Bor-Son then filed a claim in the amount of $66,184.12 in connection with Fiberglass' Chapter XI proceedings.

All actions concerning the Estherville Project were consolidated for trial. The case was heard by the U.S. District Court for the District of Minnesota, Third Division in Bankruptcy, without objection to jurisdiction by either party. Fiberglass agreed to reduce its claim by $18,181.13, which was the amount due on valid subcontractor claims. The Bankruptcy Court reduced the balance by an additional $16,572.00 for breach of contract damages. The Bankruptcy Court found that the remaining amount was unjustly withheld from Fiberglass by Bor-Son, and ordered judgment against Bor-Son for $31,488.18, plus accrued interest.

Bor-Son appealed the order to the District Court and the matter was brought before the U.S. Magistrate pursuant to 28 U.S.C. §636(c). Neither side challenged the Bankruptcy Court's jurisdiction, and the U.S. Magistrate affirmed the order of the Bankruptcy Court in all respects.

Bor-Son then appealed the decision to the United States Court of Appeals for the Eighth Circuit. Although Bor-Son did not contest the Bankruptcy Court's jurisdiction, the Court of Appeals reversed the District Court on the ground that the Bankruptcy Court could not assert summary jurisdiction over a res in which the debtor did not have a property interest. The Court of Appeals declined to address the substantive issues

and remanded the case to the District Court with direction to vacate the judgment. Fiberglass filed a Petition for Rehearing by Panel of the Eighth Circuit, which was denied on June 21, 1982.

Fiberglass now comes before the Supreme Court of the United States, asking the Court to grant certiorari to determine whether the Court of Appeals correctly ruled that the Bankruptcy Court did not have summary jurisdiction over the case, even though neither party to the action objected to the summary jurisdiction of the Bankruptcy Court.

ARGUMENT

I. The Bankruptcy Court Had Subject Matter Jurisdiction to Hear the Case.

Since the Court of Appeals did not so specify, it is important to emphasize that its holding was based upon the *summary* jurisdiction of the Bankruptcy Court. The Bankruptcy Court clearly had subject matter jurisdiction of the case under Bankruptcy Rule 2a(7), which permits the courts of bankruptcy to "Cause the estates of bankrupts to be collected, reduced to money, and distributed, and determine controversies in relation thereto . . . ." The case at bar is a controversy related to the Fiberglass estate; therefore, Rule 2a(7) conferred subject matter jurisdiction upon the Bankruptcy Court for the District of Minnesota to hear the case.

The distinction between summary jurisdiction and subject matter jurisdiction has been carefully defined in the case of *Lilienstein v. Carberry (In Re Murray)*, 82 F.2d 612 (7th Cir. 1937). Murray, a bankrupt farmer, sued in Bankruptcy Court for the return of land which one of his creditors had taken. The creditor filed an Answer, but did not challenge the

jurisdiction of the Bankruptcy Court at that time. The case proceeded on its merits, and a verdict was entered for the bankrupt. The creditor appealed, claiming that the Bankruptcy Court lacked summary jurisdiction because the action involved property which was not in the hands of the bankrupt.

The Court of Appeals upheld the jurisdiction of the Bankruptcy Court. "Having jurisdiction of the subject-matter in a plenary suit, the objection to proceeding summarily may be waived by the adverse party by an answer amounting in law to consent to the procedure. In other words, the objection to summary procedure does not go to the jurisdiction of the subject-matter but to the jurisdiction to proceed in a summary way. *This clearly may be waived.*" 92 F.2d at 614 (emphasis supplied).

The rationale and cases used by the Court of Appeals also indicate that it was addressing summary jurisdiction, not subject matter jurisdiction. The argument made by the Court, that a bankruptcy court has jurisdiction only over property which is in the actual or constructive possession of the debtor, is a primary issue in disputes over summary jurisdiction. See, e.g., *Harrison v. Chamberlin*, 271 U.S. 191, 46 S.Ct. 467, 70 L. Ed. 897 (1926). Additionally, every case cited by the Court of Appeals concerned summary jurisdiction, not subject matter jurisdiction. It is therefore apparent that the Court of Appeals denied only the Bankruptcy Court's summary jurisdiction, not its subject matter jurisdiction.

The Bankruptcy Court's subject matter jurisdiction was clearly granted by Rule 2a(7), and the Court of Appeals' opinion did not in any way dispute the subject matter jurisdiction of the Bankruptcy Court over the case, but challenged only the Bankruptcy Court's summary jurisdiction. Accordingly, the sole issue presented to the Supreme Court is whether

the Bankruptcy Court had summary jurisdiction over the case.

II. Parties to an Action May Waive Their Right to a Plenary Suit, and Consent to the Summary Jurisdiction of the Bankruptcy Court.

The Court of Appeals determined that the Bankruptcy Court did not have summary jurisdiction because Fiberglass did not hold an undisputed property interest in the money retained by Bor-Son. Ordinarily, the position taken by the Court of Appeals would be correct. However, statutory and case law provide that when a claimant waives its right to a plenary suit, the Bankruptcy Court may take jurisdiction of the case.

Congress has declared that a Defendant may consent to the Bankruptcy Court's summary jurisdiction. "Suits by the receiver and the trustee shall be brought or prosecuted only in the Courts where the bankrupt might have brought or prosecuted them if proceedings under this Act had not been instituted, *unless by the consent of the Defendant* . . . ." 11 U.S.C. §46(b) (Bankruptcy Act §23(b)) (emphasis supplied). By enacting this provision, Congress established the consent of a defendant in a suit to recover property outside the Bankruptcy Court's possession as a ground for federal jurisdiction. *Coffman v. Cobra Manufacturing Company*, 214 F.2d 489, 491 (9th Cir. 1954). Courts have uniformly upheld bankruptcy court's summary jurisdiction under Section 23(b), as shown by *MacDonald v. Plymouth Trust Company*, 286 U.S. 263, 52 S.Ct. 505, 76 L. Ed. 1093 (1932): "We can perceive no reason why the privilege of claiming the benefits of the procedure in a plenary suit, secured to suitors under Section 60(b) and

Section 23(b), may not be waived by consent, as any other procedural privilege of the suitor may be waived, and a more summary procedure substituted." 286 U.S. at 267.

Thus, a Bankruptcy Court has summary jurisdiction with respect to property not within its actual or constructive possession, if the Defendant consents to its jurisdiction. *Lindsey-Robinson & Company v. Grady*, 282 F.2d 607 (4th Cir. 1960). There is no doubt that the right to have issues tried in a plenary suit is procedural only, and may be waived by the parties. *Harris v. Avery Brundage Company*, 305 U.S. 164, 59 S.Ct. 131, 83 L. Ed. 100 (1938); *United States v. Davies (In re Read-York, Inc.)*, 152 F.2d 313, 315 (7th Cir. 1945); *Cuvrell v. Mazur (In re F & T Contractors, Inc.)*, 649 F.2d 1229, 1233 (6th Cir. 1981).

Petitioner's argument is further supported by *Harrison v. Chamberlin*, 271 U.S. 191, 46 S.Ct. 467, 70 L. Ed. 897 (1926), a case cited by the Eighth Circuit Court of Appeals in the instant case. In *Chamberlin*, the Supreme Court held that the Bankruptcy Court lacked jurisdiction, but only after ascertaining that the Respondent had not consented to the summary jurisdiction of the Bankruptcy Court. Justice Sanford, speaking for a unanimous Supreme Court, stated, "It is well settled that a Court of Bankruptcy is without jurisdiction to adjudicate in a summary proceeding a controversy in reference to the property held adversely to the bankrupt estate, *without the consent of the adverse claimant*. . . . As the Respondent's objection to summary jurisdiction of the Bankruptcy Court was well taken, *and there was no waiver of her right in this respect*, (citations omitted) the decree of the Circuit Court of Appeals is affirmed." 271 U.S. at 193, 195 (emphasis supplied).

The cases relied upon by the Court of Appeals recognize that a Defendant may consent to summary jurisdiction. "When possession is held by a third person, adverse claims may not be summarily adjudicated *unless by consent*, or unless the claim is merely colorable." *Bayview Estates, Inc. v. Bayview Estates Mobile Homeowners Association*, 508 F.2d 405, 408 (3rd Cir. 1964) (emphasis supplied). "Plenary jurisdiction is governed by Section 23(b) of the Bankruptcy Act, 11 U.S.C. §46(b). That Section requires that a plenary action be filed in a Federal District Court where an independent basis of federal jurisdiction exists, *unless the Defendant consents to jurisdiction.*" *Rubin v. Virgin Islands Refinery Corporation (In Re Co-Build Companies, Inc.)*, 408 F.Supp. 717, 720 (E.D. Penn. 1976) (emphasis supplied).

In *Hastings v. H.M. Byllesby & Co. (In re Standard Gas & Electric Co.)*, 119 F.2d 658, 660 (3rd Cir. 1941), the Third Circuit Court of Appeals ruled that jurisdiction could not be based upon consent under Section 23(b) only because the Defendants had *not* consented to be sued in that jurisdiction. Examination of a similar case led the Sixth Circuit Court to conclude, "The record here satisfies us . . . that the minimum requirements of a preliminary inquiry by the Referee were not met, particularly in view of . . . the timely challenge by Buildex to the jurisdiction of the bankruptcy court." *Willyerd v. Buildex Company*, 463 F.2d 996, 999 (1972).

The cases cited by the Court of Appeals do not support its decision—all may be distinguished because the Defendants therein all objected immediately to the Bankruptcy Court's exercise of summary jurisdiction. Not one of the cases cited by the Court of Appeals involved a Court which declared sua sponte that summary jurisdiction did not exist. Not one denied the Bankruptcy Court summary jurisdiction

where a Defendant had consented to it. It is therefore evident that the judgment of the Court of Appeals directly contradicts the great weight of authority, and it must be reversed.

III. Bor-Son's Activities Constituted a Valid Waiver of Objection to the Bankruptcy Court's Exercise of Summary Jurisdiction.

A. As a general rule, new defenses to an action are not considered on appeal.

Defenses not raised are irrevocably waived. FED. R. CIV. P. 12(G). Therefore, as a general practice, appellate courts will not pass upon questions which were not presented at trial. *Bachman v. McCluer*, 63 F.2d 580, 583 (8th Cir. 1933). "It is elementary that we should not rule upon a point of law not presented to the trial judge. A trial judge ordinarily should not be charged with error in not deciding correctly a question that he was never asked to decide." *Skogen v. Dow Chemical Company*, 375 F.2d 692, 703 (8th Cir. 1967). In *Ludwig v. Marion Laboratories, Inc.*, 465 F.2d 114, 117 (8th Cir. 1972), the Eighth Circuit Court of Appeals indicated that it would refuse to consider a question which was not presented to, or passed upon by, the trial court.

In the case at bar, Bor-Son voluntarily appeared before the trial court and litigated the merits of its claim. The jurisdiction of the Bankruptcy Court to hear the matter was not made an issue. Furthermore, neither party objected to the Bankruptcy Court's jurisdiction during the appeals to the District Court and to the Court of Appeals. Despite this, the Court of Appeals ruled that the Bankruptcy Court had no jurisdiction over the case. The ruling of the Court of Appeals

is inconsistent with the general rule that appellate courts will not address new, untried issues, and it must be vacated.

B. Under the Bankruptcy Act, any objection to a bankruptcy court's summary jurisdiction is waived if not raised at trial.

Bankruptcy Rule 2a(7) states that " . . . where in a controversy arising in a proceeding under this Act an adverse party does not interpose objection to the summary jurisdiction of the court of bankruptcy . . . he shall be deemed to have consented to such jurisdiction." Moreover, Rule 915(a) emphasizes that, "Except as provided in Rule 112 and subject to Rule 928,[1] a party waives objection to jurisdiction of an adversary proceeding or a contested matter and thereby consents to such jurisdiction if he does not make objection by a timely motion or answer, whichever is first served." It is undisputed that Bor-Son did not object to the Bankruptcy Court's summary jurisdiction at any time. Therefore, the Bankruptcy Court properly exercised its jurisdiction over the case.

The Courts have consistently held that by failing to object to the Bankruptcy Court's summary proceedings, a party waives his privilege to a plenary proceeding. *Katchen v. Landy*, 382 U.S. 323, 335, 86 S.Ct. 467, 15 L. Ed. 2d 391 (1966); *First State Bank of Crook, Colorado v. Fox*, 10 F.2d 116, 118 (8th Cir. 1925); *Coffman v. Cobra Manufacturing Company*, 214 F.2d 489, 491 (9th Cir. 1954). Any objection to jurisdiction must be explicit. *Honeyman v. Hughes*, 150 F.2d 27, 29 (9th Cir. 1946). The objection must be made either in or before the answer, *Guardian Title Company v. Sulmeyer*,

[1] Rules 112 and 928 deal with subject matter jurisdiction, which has been discussed in Part I of the Petitioner's Statement of the Case.

417 F.2d 1290 (9th Cir. 1969), and an objection on appeal is too late. *Hutcherson v. Jeffrey (In re Hutcherson)*, 133 F.2d 959 (7th Cir. 1943). A claimant must not be permitted to speculate on the outcome of a proceeding, and then, if he loses the decision, for the first time protest the procedure. *Honeyman v. Hughes*, 150 F.2d 27, 29 (9th Cir. 1946).

Bor-Son did not object at any time to the jurisdiction of the Bankruptcy Court. No objection was made to the jurisdiction in Bor-Son's answer, or any of its pleadings. The trial court record does not contain any objection to the summary jurisdiction of the Bankruptcy Court. No mention of jurisdiction is made in the briefs submitted by the parties to the Bankruptcy Court, to the District Court, or to the Court of Appeals. In effect, the Court of Appeals' decision was a "windfall" to Bor-Son, allowing the claimant to speculate on the outcome of its proceeding, only to have the Court of Appeals unexpectedly overturn the case on procedural grounds. The decision of the Court of Appeals is contrary to the great weight of law, both statutory and judicial, and must be vacated.

C. A party which files a claim in a bankruptcy proceeding consents to the summary jurisdiction of the Bankruptcy Court.

Just as the parties' failure to object confers summary jurisdiction on the Bankruptcy Court, a claimant which files its claim in a bankruptcy proceeding also invokes the summary jurisdiction of the Bankruptcy Court. *United States v. Luther*, 225 F.2d 499, 505 (10th Cir. 1955). By so presenting its claims, a claimant subjects itself to all consequences that attach to an appearance. *Katchen v. Landy*, 382 U.S. 323, 328, 86 S.Ct. 462, 472, 15 L. Ed. 2d 391, 396.

Bor-Son presented its claim of $66,184.12 to the Bankruptcy Court, then failed to object to summary jurisdiction when its claim was consolidated with the action brought by Fiberglass. Bor-Son's actions constituted consent to the Bankruptcy Court's jurisdiction to adjudicate the entire case, and the decision of the Court of Appeals denying the Bankruptcy Court's jurisdiction must be vacated.

CONCLUSION

The United States Court of Appeals for the Eighth Circuit erred when it ruled that the Bankruptcy Court did not have summary jurisdiction over the case at bar. Summary jurisdiction did exist. Bor-Son consented to summary jurisdiction both by failing to object to jurisdiction and by filing its claim against Fiberglass in Bankruptcy Court. Therefore, the decision of the Eighth Circuit Court of Appeals should be vacated, and the decision of the District Court in favor of Fiberglass Specialty Company, Inc. should be re-instated.

Dated this 23rd day of September, 1982.

Respectfully submitted,

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APPENDIX

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

In the Matter of:
FIBERGLASS SPECIALTY CO., INC.,
Debtor.

In Proceedings for An Arrangement Under Chapter XI
BKCY 3-78-367

ORDER AUTHORIZING DEBTOR TO CONTINUE IN POSSESSION

At Saint Paul, in said District, on the 3rd day of April, 1978.

Fiberglass Specialty Co., Inc., the Debtor above named, having petitioned this Court for an Order authorizing it to remain in possession of its property and affairs, as defined in the attached Petition of Fiberglass Specialty Co., Inc., at the hearing whereof no notice was given, none being required and no adverse interests appearing thereat, and the Court being advised in all the premises being satisfied that it is in the best interest of the above-named Debtor, its estate and all creditors thereof; it is

ORDERED:

1. That Fiberglass Specialty Co., Inc., be, and it hereby is, authorized to remain in possession of its properties, business and affairs until further order of this Court.

2. That Fiberglass Specialty Co., Inc., be, and it hereby is, authorized to continue the operation of its business. Such operation shall be limited in the fashion and manner described in the Petition of Fiberglass Specialty Co., Inc. The debtor-in-possession shall not contract any unusual obligations either as to subject, matter or amount. The conduct of said business shall at all times be at the discretion of this Court. For such business, the debtor-in-possession shall be authorized to incur normal overhead for rent, utilities, insurance, payroll and other administrative expenses, but shall not incur any administrative expenses beyond that normally heretofore incurred by it. The above provisions shall not be construed as authorizing the debtor-in-possession to pay any indebtedness incurred prior to the filing of the Original Petition under Chapter XI by Fiberglass Specialty Co., Inc.

3. The debtor-in-possession shall cause to be opened a new set of books as of the date of the filing of the petition under Chapter XI, which set of books shall reflect all business transactions and occurrences affecting the operation and business of the debtor-in-possession from the date of filing of said Petition under Chapter XI.

4. The debtor-in-possession shall file with the undersigned Bankruptcy Judge a report of operations of the debtor-in-possession as may hereinafter be ordered.

5. The debtor-in-possession is authorized to retain present employees at rates of pay no greater than that existing on the date of the filing of the petition herein and is authorized to hire replacement employees in the event such is required or necessary.

6. That all persons, firms, corporations, their agents, servants and attorneys, including sheriffs, marshals and their deputies be, and they hereby are, enjoined and restrained

from commencing or continuing any suits or proceedings against the above-named Debtor in this proceeding or against any properties of the above-named Debtor until the entry of the final decree in this proceeding or until further order of this Court.

BY THE COURT:
/s/ JACOB DIM
Bankruptcy Judge

IN THE DISTRICT COURT OF THE UNITED STATES
DISTRICT OF MINNESOTA, THIRD DIVISION
IN BANKRUPTCY, No. 3-78-367(D)

In re:
FIBERGLASS SPECIALTY COMPANY, INC.,
Debtor.

FIBERGLASS SPECIALTY CO., INC.,
Plaintiff,
vs.
BOR-SON CONSTRUCTION, INC.,
Defendant.

FIBERGLASS SPECIALTY CO., INC.,
Debtor,
vs.
BOR-SON CONSTRUCTION, INC.,
Claimant.

FIBERGLASS SPECIALTY CO., INC.,
Debtor,
vs.
CREWMASTERS,
Claimant.

FINDINGS OF FACT, CONCLUSIONS OF LAW, MEMORANDUM, AND ORDER FOR JUDGMENT

The above-entitled matter came on for hearing before the undersigned, the Honorable Jacob Dim, Bankruptcy Judge, on November 8, 9, 15, 21 and 26, 1979. The last briefs were filed on February 7, 1980.

Appearing for plaintiff-debtor, Fiberglass Specialty Company, Inc. (hereafter "Fiberglass") were Mr. T. Jay Salmen, Esquire and Mr. Richard J. Gabriel, Esquire of the firm of Kueppers, Kueppers, Von Feldt and Salmen. Appearing for the defendant-claimant, Bor-Son Construction, Inc. (hereafter "Bor-Son") were Mr. Jonathan Morgan, Esquire and Mr. David J. Allen, Esquire of the firm of Briggs and Morgan. No answer or appearance was made by claimant, Crewmasters, Inc. (hereafter "Crewmasters").

FACTUAL BACKGROUND

This matter arose from a construction subcontract entered into on June 29, 1975 by Bor-Son as contractor and Fiberglass as subcontractor. Fiberglass agreed to design, manufacture, and install tank covers on a water pollution control facility being built in Esterville (sic), Iowa by Bor-Son. (Transcript, pp. 4-7). Fiberglass contracted with Crewmasters to provide labor for the installation. (T. 26-27).

Fiberglass received notice to commence work on the subcontract in December, 1976. (T. 215-216; Bor-Son Ex. 3 and 4). Fiberglass began work on the erection of the tank covers in March, 1977. It completed work in November, 1977. Upon completion, Bor-Son retained $66,191.31 of the contract money to ensure payment of all liens from the work of Fiberglass.

The subcontractors of Fiberglass filed liens and Bor-Son continued to retain the funds. On March 28, 1978, Fiberglass filed for an Arrangement under Chapter XI. On that date,

pursuant to Rule 11-44, an automatic restraint on any actions against the debtor and his property became effective. On April 3, 1978 an order from this court restrained every action and proceeding against Fiberglass and its property. On May 18, 1978, Bor-Son was notified of the filing and a demand was made for the funds retained by Bor-Son. (T. 163-165; Fiberglass Ex. 14). On September 18, 1978, Fiberglass commenced an action to recover the funds retained by Bor-Son.

On September 29, 1978, Bor-Son notified Fiberglass that certain doors installed by Fiberglass had to be replaced. Bor-Son told Fiberglass that the doors were defective and that they were still covered by the warranty of Fiberglass (Bor-Son Ex. 34). Fiberglass took no steps to correct the work and Bor-Son had the work done and backcharged Fiberglass (T. 252-254). The amount expended to replace the doors was $3,872.00.

On October 16, 1978, Bor-Son informed Fiberglass that all subcontractors would be paid by Bor-Son if they were not paid by Fiberglass prior to October 23, 1978. (Bor-Son Ex. 40). Bor-Son made the payments to the subcontractors to recover the money held by the City of Esterville (sic) on its contract. (T. 265-266). In October and November of 1978, Bor-Son paid all claimants who filed liens on the Estherville project in a total amount of $62,112.72.

On May 29, 1979, Bor-Son filed a claim for $66,184.12 against Fiberglass. On June 5, 1978, Crewmasters filed a claim for $29,456.22 against Fiberglass.

MEMORANDUM

Six issues are presented to this court for resolution. The first issue is a determination of who had title to the funds retained by Bor-Son. Second is the effect of the payments to the subcontractors by Bor-Son. Third is a resolution of the

liability for crane services. Fourth is a decision on whether Fiberglass breached its warranty. Fifth is the question of the claim of Crewmasters. Finally, there is a determination as to whether interest can be paid on the claims of the subcontractors of Fiberglass.

Bor-Son retained the sum of $66,191.31 at the completion of work by Fiberglass. Bor-Son had a right to retain the money pursuant to Paragraph F of the subcontract, but Bor-Son had no claim of title to the funds. It retained the money to ensure that all liens would be satisfied. It did not own the money after Fiberglass completed the work, nor under the contract, could it dispose of the money.

Bor-Son contends that under the doctrine of *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 83 S.Ct. 232, 9 L.Ed. 2nd 190 (1962), it had a right to make the payments to the subcontractors despite its knowledge of this action and the filing of the Chapter XI petition and the stay invoked thereby. Its reliance is misplaced.

Pearlman held that a surety obligated to make payments on its bond to subcontractors and employees of a contractor employed by the United States had title to the funds retained by the United States prior to the time title passed to the estate of the debtor. The instant case is distinguishable. Title to the retainage passed to the estate of Fiberglass before any payments were made by Bor-Son. Payment was made out of the funds of Fiberglass. Finally, and most significantly, Bor-Son had no obligation to make the payments. It did so voluntarily, contrary to the order of this court, and solely for its own economic advantage to collect over $400,000 due it on the total project.

But Bor-Son has benefited the estate to the extent it has paid claims which would be allowed. While it should not be

allowed to improve its or the creditors' position, its payments will be considered assignments of the claims. To the extent allowed by this court, these claims may be set off against its liability to Fiberglass. It was stipulated at trial that three of the claims are to be allowed in a total amount of $18,181.13. The claims are: Stall's Farm & Home, $480.26; K & S Lumber Company, $400.87; Dahl Air Conditioning & Heating, $17,-250.00. These may be used to reduce the liability of Bor-Son to Fiberglass.

The remaining payments were disputed by Fiberglass. The liability for crane services is based on Bor-Son's obligation in the subcontract to provide crane services. Bor-Son claims that this obligation terminated when Fiberglass allegedly breached the contract, and it, therefore, did not provide a crane for Fiberglass.

Paragraph 3 of the subcontract calls for Fiberglass to commence "the work of this subcontract" within 3 days of receiving notice to proceed. Fiberglass did not begin installation until 3 months after receiving notice. The contention of Fiberglass is that it began work prior to receiving the notice by designing and manufacturing the tank covers. This contention is contrary to the plain language of the contract viewed as a whole and the intent of the parties. The purpose of the contract was to provide for the installation of the tank covers. The purpose of Paragraph 3 was to allow Bor-Son to have this work begun when the project was ready. Under the interpretation advanced by Fiberglass, no work need be commenced until notice was received. Clearly, this was not the intent of the parties at the time of execution. The actions taken by Fiberglass in designing and manufacturing the tank covers prior to any notice to proceed; in not informing Bor-Son of this contention until 3 months after receiving notice; in prom-

ising to commence work in January; and, in making a $2,000.00 payment for crane services indicate that Fiberglass operated under the same interpretation as Bor-Son.

Fiberglass breached the contract by failing to proceed as scheduled. This court finds that such breach excuses the performance of Bor-Son, that Bor-Son fully performed the contract, and that Bor-Son's damages are measured by the cost of crane services provided to Fiberglass by Holm Brothers Plumbing & Heating in the amount of an additional $12,700.00 paid by Bor-Son.

Bor-Son is entitled to setoff against its liability to Fiberglass, the amount paid by Bor-Son to Holm Brothers Plumbing and Heating, $12,700.00.

Bor-Son also claims a right to set off $3,872.00 paid to correct certain defective work of Fiberglass. The doors were required to be replaced. No evidence was submitted showing any abuse or damage by a third party. The doors were covered by a one year warranty given by Fiberglass in Paragraph 15 of the subcontract.

The warranty given by Fiberglass was to protect Bor-Son in the event the work done and materials used failed to meet contract specifications. The fact the defect did not arise until September 1978 does not alter the obligation of Fiberglass. It is the purpose of the warranty to protect against defects which arise after completion of the work.

The doors, selected and supplied by Fiberglass, were defective and covered by the warranty. Bor-Son is entitled to set off the amount of $3,872.00 against the liability owed to Fiberglass by Bor-Son.

Bor-Son made a payment of $29,526.12 to Crewmasters. Crewmasters made no appearance at trial nor did Bor-Son undertake to represent Crewmasters. Fiberglass presented

evidence showing it had paid Crewmasters and showing that Crewmasters breached its contract causing damages to Fiberglass of $16,106.00.

Bor-Son disputes the proof of Fiberglass in regard to the payment of Crewmasters. It claims Crewmasters applied payments received from Fiberglass on other claims it had against Fiberglass under the doctrine set forth in *General Electric Co. v. Anchor Casualty Co.*, 251 Minn. 305, 87 N.W. 2d 639 (1958). Two elements necessary to apply the doctrine are missing. First, payments must be shown to have been applied to a particular indebtedness. No such showing was made. Second, the creditor must notify the debtor within a reasonable time after application. The only notice was made in this trial and such notice was not made in a reasonable time.

The proper rule to be applied is first money in, first money out. Applying this rule, no money is due on the claim filed by Crewmasters.

In light of the default by Crewmasters and the proofs offered by Fiberglass, the objection to the claim of Crewmasters must be upheld and the claim expunged.

The final issue concerns interest paid by Bor-Son on the claims of the subcontractors. It is well settled that interest is not accrued after the filing of the petition. *American Iron & Steel Mfg. Co. v. Seaboard Air Line Railway Co.*, 233 U.S. 261, 34 S.Ct. 502, 58 L.Ed. 959 (1914). Only in cases where the debtor is ultimately proved solvent is interest allowed. This is not such a case.

CONCLUSIONS OF LAW

1. Jurisdiction is founded on §§2(a)(2), 2(a)(15) and 23(b).

2. Bor-Son Construction, Inc. is liable to Fiberglass Specialty Company, Inc. for the $66,191.31 retained from the subcontract payment to Fiberglass Specialty Company, Inc.

3. Bor-Son Construction, Inc. is entitled to deduct from the amount owed to Fiberglass Specialty Company, Inc. the following payments:

a.	Stall's Farm & Home	$ 480.26
b.	K & S Lumber Company	400.87
c.	Dahl Air Conditioning & Heating	17,250.00
d.	Holm Brothers Plumbing & Heating	12,700.00
e.	Warranty payments	3,872.00
	Total deductions	$34,703.13

4. The claim of Crewmasters, Inc. against Fiberglass Specialty Company, Inc. is expunged.

5. The claim of Bor-Son Construction, Inc. against Fiberglass Specialty Company, Inc. is expunged.

6. Fiberglass Specialty Company, Inc. is entitled to recover the sum of $31,488.18 from Bor-Son Construction, Inc.

ORDER FOR JUDGMENT

In accordance with the foregoing, IT IS ORDERED and ADJUDGED:

1. The claim of Crewmasters, Inc. is expunged. (No. 88)

2. The claim of Bor-Son Construction, Inc. is expunged. (No. 156)

3. Bor-Son Construction, Inc. shall pay to Fiberglass Specialty Company, Inc. the sum of $31,488.18, together with interest from the date judgment is entered.

The foregoing Opinion, based on all the evidence, oral and written, adduced at trial, and based on all pleadings and papers filed therein, constitutes the Findings of Fact, Conclusions of Law and Order for Judgment.

LET JUDGMENT BE ENTERED ACCORDINGLY.

Dated at St. Paul, Minnesota, this 7th day of April, 1980.

JACOB DIM
Bankruptcy Judge

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION
Civil No. 4-80-316

FIBERGLASS SPECIALTY CO., INC.,
Plaintiff,

v.

BOR-SON CONSTRUCTION, INC.,
Defendant.

ORDER

This matter is before the Court on cross-appeals from an Order of the bankruptcy court in an adversary proceeding between the debtor, Fiberglass Specialty Co., Inc. (Fiberglass) and Bor-Son Construction, Inc. (Bor-Son). T. Jay Salmen, Esquire, and Richard J. Gabriel, Esquire, represent Fiberglass; Jonathan H. Morgan, Esquire, and David J. Allen, Esquire, appear for Bor-Son. The parties have consented to have this matter determined by the undersigned United States Magistrate; an Order of reference was issued by the Honorable Harry H. MacLaughlin, United States District Court Judge, pursuant to Title 28, United States Code, Section 636 (c) on June 25, 1980. The Order of the bankruptcy court is affirmed in all respects.

MEMORANDUM

Bor-Son, the general contractor in charge of the construction of a water pollution control facility for the city of Esterville, Iowa, entered into a subcontract with Fiberglass for $443,000.00 on August 11, 1975 in which Fiberglass agreed to design, manufacture and install tank covers for the facility. Fiberglass then subcontracted with Crewmasters, Inc.[1] to

[1] Crewmasters, Inc. was also known as Ultra Enterprises.

provide labor for the onsite erection of the Fiberglass products. Under the terms of the Bor-Son/Fiberglass contract the debtor was to begin work within three days of receiving notice from Bor-Son (paragraph 3 of the contract). Fiberglass received notice to commence work on the project in December 1976. Fiberglass later notified Bor-Son that it could begin onsite construction in January 1977; however, Fiberglass did not actually begin onsite work on the erection of the tank covers until March 1977. The contract also required Bor-Son to furnish a crane for the unloading and erection of the tank covers. Pursuant to the contract Bor-Son had made a crane available for Fiberglass' use for 27 days in December 1976 and January 1977 after having notified Fiberglass to commence work. When Fiberglass did not appear at the construction site, Bor-Son informed them that they would have to make their own arrangements for the provision of crane services.

When Fiberglass finally appeared at the site in March 1977 they contracted with Holm Brothers for crane service. Holm Brothers billed Fiberglass $14,700.00 for the use of its crane. Fiberglass paid Holm only $2,000.00, being unable to pay the balance. Bor-Son eventually paid the balance of $12,700.00 owing to Holm on November 9, 1978.

The bankruptcy judge found that Fiberglass' failure to commence work in December 1976 was a breach of contract which excused Bor-Son of its duty to provide crane services to Fiberglass. The bankruptcy court found that Bor-Son's damages were $12,700.00, the amount of the additional crane service provided by Holm which was paid by Bor-Son.

Fiberglass completed work on the project in November 1977. Upon completion, Bor-Son, pursuant to paragraph F of the contract, retained $66,191.31 of the contract money owing to Fiberglass to insure payment of all liens from the Fiber-

glass work. Four subcontractors of Fiberglass filed liens and Bor-Son continued to retain these funds. On March 28, 1978, Fiberglass filed for an arrangement under Chapter 11 of the bankruptcy laws, at which time, pursuant to Bankruptcy Rule 11-44 an automatic stay on any actions against the debtor and his property became effective. On April 3, 1978, the bankruptcy judge issued an Order restraining every action and proceedings against Fiberglass and its property. On May 18, 1978 Bor-Son was notified of the filing for an arrangement and a demand was made for the funds retained by Bor-Son. (T. 163-165; Fiberglass Exhibit 14.) On September 18, 1978 Fiberglass commenced an action to recover the money retained by Bor-Son.

On September 29, 1978 Bor-Son notified Fiberglass that certain doors installed by Fiberglass on the project, which were still covered by the warranty of Fiberglass, were defective and had to be replaced. (Bor-Son Exhibit 33.) Fiberglass took no action to correct the work; Bor-Son then had the work done and charged Fiberglass for the amount of the work, $3,872.00 (T. 252-254).

On October 16, 1978, about six months after the filing of the bankruptcy petition, Bor-Son informed Fiberglass that all subcontractors would be paid by Bor-Son if they were not paid by Fiberglass prior to October 23, 1978 (Bor-Son Exhibit 40). Bor-Son, without obtaining the permission of the bankruptcy court, made the payments to the subcontractors so that it could recover over $400,000.00 held by the city of Esterville on its contract (T. 265-266). In October and November of 1978 Bor-Son paid all claimants who had filed liens on the Esterville project in a total amount of $62,112.72. Among the various liens paid by Bor-Son was a payment of $29,526.12 to Crewmasters. Fiberglass presented evidence that it had al-

ready paid Crewmasters the $29,526.12 and that Crewmasters had breached its contract causing damage to Fiberglass in an amount of $16,106.00.

On May 29, 1979, Bor-Son filed a claim for $66,184.12 against Fiberglass. On June 5, 1978, Crewmasters filed a claim for $29,456.22 against Fiberglass. No answer or appearance was made by Crewmasters and the court expunged it claim.

The bankruptcy judge found that Bor-Son was liable to Fiberglass for $66,191.31, the amount retained from Fiberglass under the contract pursuant to paragraph F. The Court also found that Bor-Son was entitled to deduct from the amount owed Fiberglass the following payments that had been made by Bor-Son to creditors of Fiberglass:

A.	Stall's Farm & Home	$ 480.26
B.	K & S Lumber Company	400.87
C.	Dahl Air Conditioning & Heating	17,250.00
D.	Holm Brothers Plumbing & Heating	12,700.00
E.	Warranty payments	3,372.00
	TOTAL DEDUCTIONS	$34,703.13

The bankruptcy judge allowed Bor-Son a credit on the above payments because these payments had benefitted the debtor's estate. The bankruptcy judge refused to allow Bor-Son to deduct the $29,526.12 payment that had been made to Crewmasters. Each party appeals from different portions of the bankruptcy court's order contending that certain findings of the bankruptcy court are not supported by the evidence. Each party also contends that the bankruptcy court erred in interpreting the laws.

It is axiomatic that the bankruptcy court's findings of fact are to be accepted as conclusive unless they are clearly erroneous. See *Matter of PRS Products, Inc.*, 574 F.2d 414, 417 n.4

(8th Cir. 1978); *Mann v. Shepard* (In re Grevich), 570 F.2d 247, 249 n.3 (8th Cir. 1978); *Solari Furs v. United States*, 436 F.2d 683, 684 (8th Cir. 1971). Factual findings are presumptively correct and the complaining party has the burden of clearly demonstrating that error exists. *Friedman v. Fordyce Concrete Inc.*, 362 F.2d 386, 387 (8th Cir. 1966). A finding is clearly erroneous when although there is evidence to support it the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed. *Joseph A. Bass Company v. United States*, 340 F.2d 842, 843-844 (8th Cir. 1965).

I have studiously examined the evidence in light of the foregoing rules and have no difficulty in reaching the conclusion that the court's findings of fact are not clearly erroneous and that its conclusions of law and ultimate judgment are not entitled to be disturbed.

Fiberglass Appeal

Fiberglass argues that the bankruptcy judge erred in two respects. First, Fiberglass contends that the bankruptcy judge erred in allowing Bor-Son to deduct $12,700.00 for its payment to Holm Brothers for the crane services provided to Fiberglass. That contention is without merit.

The bankruptcy court reasoned as follows. The Bor-Son/Fiberglass subcontract required Bor-Son to provide crane service to Fiberglass for the erection of the tank covers. That obligation was terminated when Fiberglass breached the subcontract by failing to begin onsite work on the tank covers within three days of receiving notice in December 1976. Fiberglass did not begin actual construction until March 27, 1977. Thus, Bor-Son was not obligated to provide crane service when Fiberglass actually began work. As the later payment of $12,700.00 by Bor-Son for the crane service benefitted the

debtor's estate, Bor-Son's payment could be set off against its liability to Fiberglass for the $66,191.31 that it had withheld in the retainage fund.

Fiberglass advances two lines of reasoning. First, it argues that it did not breach paragraph 3 of the contract, relating to the time at which it was to commence work, because it had already begun fabrication of the panels in its own facilities before the notice was received. Under Fiberglass' interpretation of the contract it had actually commenced work before receiving notice to begin work.

The bankruptcy judge properly construed paragraph 3 of the subcontract. His interpretation rests on a sound basis, both legally and factually, and requires no further elaboration by this Court. In the words of the bankruptcy court:

> "Paragraph 3 of the subcontract calls for Fiberglass to commence 'the work of this subcontract' within three days of receiving notice to proceed. Fiberglass did not begin installation until three months after receiving notice. The contention of Fiberglass is that it began work prior to receiving the notice by designing and manufacturing the tank covers. This contention is contrary to the plain language of the contract viewed as a whole and the intent of the parties. The purpose of the contract was to provide for the installation of tank covers. The purpose of paragraph 3 was to allow Bor-Son to have this work begun when the project was ready. Under the interpretation advanced by Fiberglass, no work need be commenced until notice was received. Clearly this was not the intent of the parties at the time of execution. The actions taken by Fiberglass in designing and manufacturing the tank covers prior to a notice to proceed; in not informing Bor-Son of this intention until three months after receiving

notice; promising to commence work in January; and, in making the $2,000.00 payment for crane services indicates that Fiberglass operated under the same interpretation as Bor-Son."

Second, Fiberglass asserts that there was not sufficient evidence to support a finding of a contract modification which would relieve Bor-Son of its obligation to provide the crane. Fiberglass' argument misses the mark. The bankruptcy judge did not rely on a modification theory in reaching his conclusion. His theory was that breach of the contract by Fiberglass, and not a modification, relieved Bor-Son of its obligation to provide crane service under the contract. See, *Corbin on Contracts*, §975. That Bor-Son cannot establish a right to set off under a modification of contract theory is of no significance whatsoever because neither the bankruptcy court nor Bor-Son has attempted to do so.

Neither did the bankruptcy court err in determining the measure of damages on the Holm Brothers claim. Fiberglass asserts that Bor-Son should not have been allowed to off set the full $12,700.00 it paid to Holm because it was obligated to provide crane service to Fiberglass under the subcontract. That contention is without merit. The breach of Fiberglass is not commencing work in a timely fashion relieved Bor-Son of its contractual obligation to provide crane service. As a result of the breach Fiberglass was obligated to make its own arrangements for crane service and Bor-Son paid the bill. Allowing Bor-Son to off set the full amount of its payment to Holm is not unjust enrichment.

Fiberglass' second major assignment of error is that the court's finding that the doors were defective under the Fiberglass warranty was not supported by the evidence. There was an adequate factual basis in the record from which the bank-

ruptcy judge could have found that Fiberglass breached its warranty with respect to the doors. Robert Wolters, Bor-Son's project manager, testified that from his observation the doors were not of the quality required for a commercial installation (T. 254). The project owner, the City of Esterville, required the door to be corrected prior to final payment (T. 312). In paragraph 15 of the contract Fiberglass guaranteed that its work would conform to the standards of the owner. The "punch list" of June 15, 1978 submitted by the owner's representative also required replacement of the doors (T. 310-311). Also received in evidence were two letters received by Bor-Son to Fiberglass relating to corrective work needed on the doors. Bor-Son eventually paid $3,700.00 to replace them.

Fiberglass argues that the doors were constructed in accord with certain shop drawings (which were prepared by Fiberglass), that the doors were in good working order when installed, and that therefore it is reasonable to assume that any damage was caused by other tradesmen.

The bankruptcy court was not required to accept the statement by Mr. Risgard, the debtor's president, that the doors were acceptable and in working order when installed, and there is no substantial evidence to suggest that other tradesmen on the project were responsible for the damage. The conflicts in the evidence were for the trial court to resolve. I cannot say that the court's finding with respect to the doors was clearly erroneous.

The appeals raised by Fiberglass in this case are without merit.

Bor-Son's Appeal

Bor-Son raises several challenges to the factual findings and legal conclusion of the bankruptcy court with respect to the Court's finding that Bor-Son is liable to Fiberglass for

$31,488.18. It is most convenient to deal with issues raised in the following order.

First, Bor-Son argues that the bankruptcy court made no specific finding of any "overpayment" or "double payment" to Crewmasters, and that in the absence of such a finding Bor-Son should be allowed to deduct the payment it made to Crewmasters just as it was permitted to deduct the payments it made to other creditors of Fiberglass. The bankruptcy court did state that "Fiberglass presented evidence that it had paid Crewmasters."

While it is true that the court did not explicitly state that the $29,526.12 payment to Crewmasters was a "double payment" or "overpayment", such a finding is clearly implicit in the court's holding. The court allowed Bor-Son a credit for those claims it had paid to the extent that the payments had benefitted the debtors estate. Clearly implicit in the court's statement that it would allow a credit for payments that had benefitted the Fiberglass estate, and the court's disallowance of the $29,526.12 payment, is the finding that the payment to Crewmasters was an overpayment which did not benefit the debtor's estate.[2]

Bor-Son goes on to argue that the evidence does not support the finding of a double payment to Crewmasters. It first attacks the credibility of Fiberglass' primary witness, John Rysgaard, the former president of Fiberglass, arguing that Rys-

[2] There is little doubt that the bankruptcy court believed that the payment by Bor-Son to Crewmasters had been a double payment. In the portion of the court's order relating to Bor-Son's contention concerning the doctrine of application of payments the court said at p. 7: "The proper rule to be applied is first money in, first money out. Applying this rule, no money is due on the claim filed by Crewmasters . . . In light of the default by Crewmasters and the proofs offered by Fiberglass, the objection to the claim of Crewmasters must be upheld and the claim expunged."

gaard was not competent to testify under Rule 602 of the Federal Rules of Evidence because he lacked personal knowledge of the transaction. Bor-Son's argument is supported only by a reference in its brief to certain portions of the transcript where Rysgaard states that he never personally visited the construction site in Esterville.

Rysgaard testified that the total of approved invoices received by Fiberglass amounted to $63,654.94, and that Fiberglass had paid Crewmasters $63,940.35 resulting in an overpayment by Fiberglass of $385.31 (T. 49-51). It is axiomatic that determinations of credibility are the province of the bankruptcy judge who had the opportunity to hear the testimony of the witness and observe his demeanor. The fact that Rysgaard had not been present at the construction site does not mean that he could not testify as to invoices received and payments made; the question was whether he could testify as to billings and payments, not whether he had visited the construction site. Rule 602 is no basis for rejecting Rysgaard's testimony.

Bor-Son next contends that the documents relied on by Fiberglass to show that it had already paid Crewmasters were improperly received into evidence and that without such evidence a finding of double payment cannot be made. The gist of the Bor-Son attack is that Exhibit 6, a computer printout listing invoices and payments, did not qualify under the business records exception, Rule 803(6), of the Federal Rules of Evidence.

I find it unnecessary to determine the admissibility of Exhibit 6 under the business records exception. Even if its reception was error, it was harmless error because there was other competent evidence sufficient to support the judgment. It is well settled that a court will not reverse a judgment for

the erroneous reception of evidence where there is other competent evidence to support it. *Lovett v. Shuster*, Slip Op. 80-1316, October 22, 1980, Eighth Circuit.

There was other competent evidence in the form of the testimony of Mr. Rysgaard, Exhibit 7, a "summary of facts relative to Ultra/Crewmasters," and Exhibit 8, "checks issued by Fiberglass to Crewmasters," to support the finding. The "summary of facts" was based upon an abstract of all checks issued to Crewmasters under the agreement for work performed as evidenced by invoices received by Fiberglass. Rysgaard personally reviewed all invoices during an audit used in preparing the summary.

The reception into evidence of the summary of fact was clearly proper. Summaries of accounting or detailed records have long been approved for evidential use before juries or judges. The use of such summaries is not only proper, but also advisable and their use is to be encouraged where it facilitates the understanding of complex factual issues. See *Boston Securities, Inc. v. U. S. Bonding Insurance Co.*, 441 F.2d 1302, 1303 (8th Cir. 1971); *United States v. Smallwood*, 443 F.2d 535, 540 (8th Cir. 1971); *Peter Kiewit Sons Company v. Summit Construction Company*, 422 F.2d 242, 266-267 (8th Cir. 1969); *United States v. Strauss*, 473 F.2d 1262, 1263 (3rd Cir. 1973). The admission and use of such summaries rests with the sound discretion of the trial judge, whose actions in allowing their use may not be disturbed in an appellate court except for an abuse of discretion. *Smallwood, supra*, 443 F.2d at 540. Mr. Rysgaard, who prepared the summary, was available for cross-examination during trial, and the records upon which the summary was based were available to Bor-Son and introduced into evidence at trial. It cannot be said that the court abused its discretion in these circumstances. The testimony of Mr.

Rysgaard, the summary of facts, and the checks themselves were sufficient to support a finding of an overpayment to Crewmasters.

Bor-Son argues that the summary of facts, Exhibit 6, was based upon the computer printout, Exhibit 7, and since Exhibit 7 was not admissible neither is Exhibit 6. That argument is not supported by the record. While it is true that Rysgaard partially relied upon the printout in preparing the summary, his later testimony clearly indicates that the printout was not his only source. Also relied upon was an abstract of all checks issued to Crewmasters and a complete recap of individual invoices received from them. (T. 49, 91-93). Furthermore, there was nothing contained in the computer printout relevant to this issue that was not also verified by the checks and invoices. There was sufficient competent evidence to support a finding of an overpayment to Crewmasters by Bor-Son.

Although Bor-Son presented evidence suggesting that no double payment had been made, the weight to be accorded such evidence, in light of the conflicting evidence offered by Fiberglass, was to be determined by the bankruptcy court. I am not left with a definite and firm conviction that an error has been committed and accordingly find the evidence sufficient to support a finding of an overpayment by Bor-Son.

Bor-Son's second major argument is that under the rule announced in *Pearlman v. Reliance Insurance Company*, 371 U.S. 132 (1962), it was entitled to the money in the retainage fund; that the fund was, as a matter of law, not the property of Fiberglass; and that it was entitled to make the payment to Crewmasters from the fund. Bor-Son's reliance on *Pearlman* is misplaced. In *Pearlman* a contractor entered into a contract with the government to perform construction work on the St. Lawrence seaway project. As required by statute,

the contractor also secured from an insurance company two bonds guaranteeing the performance of the work and payment to all persons supplying labor for the job. Under the contract the government was authorized to retain and hold a percentage of estimated amounts due monthly until final completion. The contractor defaulted, terminated its contract with the government by agreement, and the surety paid laborers and materialmen to discharge debts of the contractor to the laborers and materialmen. The contractor then filed for bankruptcy and a dispute arose between the trustee and the surety as to rights to the retainage fund.

The sole issue was "whether the surety had, as it claimed, ownership of an equitable lien on, or a prior right to this fund before bankruptcy adjudication." 371 U.S. at 136. Applying well settled principles of equitable subrogation, the court found that the surety had obtained an interest in the retainage fund by virtue of its payment to the laborers and that its interest in the fund, which existed prior to the filing of the bankruptcy, did not divolve to the trustee when the contractor filed for bankruptcy.[8] *Pearlman* turned on well settled principles of equitable subrogation: a surety who pays the debt of another is entitled to all the rights of the person he paid to enforce his right to be reimbursed. 371 U.S. at 136-137. Bor-Son argues that under the principle of equitable subrogation announced in *Pearlman*, the retainage fund was not the property of the debtor and did not become subject to the jurisdiction of the bankruptcy court. That case is distinguishable for the following reasons.

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[8] The filing of a bankruptcy petition creates an estate comprised of all legal and equitable interests of the debtor in property. This estate passes to the trustee in bankruptcy upon filing of the petition. See *Missouri v. United States Bankruptcy Court*, Slip Op. 80-2179, April 8, 1981, Eighth Circuit.

First, the laborers and materialmen who were paid by the surety in *Pearlman* had valid claims against the bankrupt contractor; Crewmasters, on the other hand, had no right to any of the money in the retainage fund because it had already been paid the amount owing it by Fiberglass. There was no debt owing to Crewmasters by Fiberglass at the time Bor-Son made the payment. Bor-Son cannot make a gratuitous payment to Crewmasters and then deduct that payment from the amount it owed to Fiberglass.

Second, even if there had been no double payment to Crewmasters the *Pearlman* decision would still be inapplicable. Bor-Son misapprehends the fundamental principles of equitable subrogation underlying that decision. The crucial distinguishing feature is that the surety in *Pearlman* made its payment to the laborers before the contractor filed for bankruptcy. In *Pearlman*, the surety's equitable interest in the retainage fund, which it acquired under principles of equitable subrogation, arose prior to the commencement of the bankruptcy, and the court simply held that this equitable interest of the surety was not the property of the bankrupt contractor and therefore could not pass to the trustee in bankruptcy as part of the bankrupt contractor's estate.

Bor-Son, on the other hand, made the payment in question here after the commencement of the Chapter 11 proceedings. In this case, Bor-Son, unlike the surety in *Pearlman*, had not acquired any interest through equitable subrogation at the time the petition was filed; it did not make the payment to Crewmasters until after the filing and after the bankruptcy court had acquired jurisdiction over the debtor's interest in the fund. Once Fiberglass' interest in the fund became subject to the jurisdiction of the bankruptcy court by virtue of the filing of the petition, Bor-Son could not acquire a superior

interest in the fund under principles of equitable subrogation by virtue of a payment to a creditor of Fiberglass which was neither authorized by the contract nor approved by the bankruptcy court.

Similarly, Bor-Son's contention that "Fiberglass had absolutely no property interest in the [retainage] fund whatsoever" is without merit. Bor-Son concedes in its brief (p. 4) that Fiberglass performed all of its field work under the contract. Bor-Son argues that Fiberglass was not entitled to the fund because Fiberglass breached subparagraph 2 of the contract, which required it to pay all its subcontractors promptly and to keep the project free and clear of all claims and liens arising from its work. While it appears undisputed that liens were filed on the project, that fact did not divest Fiberglass of its interest in the fund or give Bor-Son a right to pay the creditors of Fiberglass with the retainage. In subparagraph F of the contract, the parties themselves agreed on the course to be followed if creditors of Fiberglass filed claims against the project. Under that paragraph Bor-Son was given the authority to withhold money owing to Fiberglass and to hold it in a retainage fund pending legal settlement of the claims. That paragraph provides:

> "F. If notification of any claims have been made against the Subcontractor or the Contractor arising out of labor or materials furnished the project or otherwise on account of any actions or failures to act by the Subcontractor in the performance of this Subcontract, the Contractor may at his discretion, withhold such amounts otherwise due or to become due hereunder to cover said claims and any costs or expenses arising or to arise in connection therewith pending legal settlement thereof."

This provision did not give Bor-Son authority to unilaterally determine the validity of, and make payment on, such claims. Neither does it provide that Fiberglass loses its interest in the fund in the event claims are filed. It only allows Bor-Son to withhold funds until "legal settlement" of the claims. Subparagraph F set out the procedures to be followed in the event creditors of Fiberglass filed claims against the project; it did not authorize Bor-Son to pursue the course of action that it undertook. Fiberglass had performed all of its field work under the contract and the interest of Fiberglass in the fund was "property of the debtor" over which the bankruptcy court acquired jurisdiction upon the filing of the petition.

Bor-Son's third argument is that Fiberglass is barred from raising the defense that it had previously paid Crewmasters because payment is an affirmative defense which Fiberglass waived by failing to raise it in its reply to Bor-Son's counterclaim. Rule 8(c) of the Federal Rules of Civil Procedure requires a party to set forth affirmative defenses, such as payment, in its pleadings.

That Fiberglass did not plead payment as a defense in its reply to the counterclaim is no basis for disturbing the bankruptcy court's judgment. The issue as to the overpayment was fully tried before the bankruptcy judge. Where an affirmative defense that was not pled is fully tried, evidence regarding it is received, and no objection is made on the ground that the evidence is not within the issues raised by the pleadings, a pleading may be deemed to be amended to conform to the proof. See Federal Rule of Civil Procedure 15(b). Most importantly, Bor-Son does not even allege that it was in any way prejudiced by the failure of Fiberglass to plead payment as an affirmative defense. A mere technical violation of Rule 8(c), without even an allegation of prejudice by Bor-Son, is no basis for disturbing the trial court's decision.

Bor-Son's fourth major argument is that even if there was an overpayment by Bor-Son, and even if Fiberglass is not barred from attempting to establish such an alleged overpayment under Rule 8(c), Fiberglass must nevertheless bear such cost because of 1) negligence, 2) estoppel, 3) ratification, 4) indemnity, and 5) restitution. It does not appear from the record that these issues were raised at trial and the bankruptcy judge made no findings or conclusions with respect to them. An appellate court should not rule on issues raised for the first time on appeal which have not been addressed by the trial court. This court should review only those issues decided by the trial court which were properly presented to it. *Union Bank v. Blum*, 460 F.2d 197, 202 (9th Cir. 1972); *In re Gardner*, 455 F.Supp. 327, 329 (N. D. Ala. 1978).

Bor-Son next argues that Fiberglass is liable for Bor-Son's payment to Crewmasters under the law of application of payments, *General Electric Co. v. Anchor Casulty* (sic) *Co.*, 251 Minn. 305, 87 N.W.2d 639 (1958). Bor-Son argues that even if Fiberglass had already paid Crewmasters for the work done at the Esterville (sic) project, Crewmasters had applied those payments as credit for work done by it for Fiberglass on other construction projects. Therefore, Bor-Son's payment to Crewmasters did not constitute a double payment.

The only evidence to suggest that Crewmasters ever made such an allocation is a summary sheet sent by Crewmasters to Fiberglass after the bankruptcy petition had been filed which lists billings by Crewmasters of $40,015.85 and a partial payment by Fiberglass of $10,559.63. The summary sheet contains no information relative to payments made on other projects. The doctrine of application of payments requires that (1) the payments must be shown to have been applied to a particular indebtedness and (2) the creditor must notify the

debtor within a reasonable time after the application. The summary sheet referred to above, Bor-Son Exhibit 1, is not adequate to establish that an application of payments had been made by Crewmasters. Even if it were adequate to show a particular application of payments, Fiberglass was not given reasonable notice of the application.

Finally, Bor-Son claims that the bankruptcy court erred in refusing to give it credit for interest it paid on the claims of the Fiberglass creditors. The bankruptcy court held that interest on claims against a debtor does not accrue after the filing of the petition and is allowed only in cases where the debtor is ultimately proved solvent. *American Iron & Steel Mfg. Co. v. Seaboard Air Line*, 233 U.S. 261 (1914); *Sexton v. Dreyfus*, 219 U.S. 339 (1911); *Collier* Vol. 3A §63.16. Bor-Son has cited no authority to the contrary.

The bankruptcy court's order is in all respects affirmed.

FLOYD E. BOLINE
United States Magistrate

Dated: May 18, 1981.

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 81-1647

In re: Fiberglass Specialty Co., Inc.,

Appellee,

v.

Bor-Son Construction, Inc.,

Appellant.

Appeal from the United States District Court for the District of Minnesota.

Submitted: December 15, 1981
Filed: May 19, 1982

Before LAY, Chief Judge, HENLEY and ARNOLD, Circuit Judges.

LAY, Chief Judge.

At issue in this appeal is the bankruptcy court's jurisdiction to adjudicate the respective rights of a bankrupt subcontractor and a general contractor in money retained by the general contractor under their subcontract.

On June 29, 1975, Fiberglass Specialty Co. entered into an agreement to design, manufacture, and install tank covers on a water pollution control facility being built in Estherville, Iowa, by Bor-Son Construction, Inc. Thereafter, Fiberglass subcontracted with Crewmasters to provide labor for the installation. Fiberglass began erecting the tank covers in March 1977. It completed work in November 1977. Upon com-

pletion, Bor-Son retained $66,191.31 of the contract money to ensure payment of all liens arising from the work of Fiberglass. Under clause two of the subcontract, Fiberglass agreed:

> To pay for all materials, skills, labor and equipment used in or in connection with the performance of this Subcontract, when and as bills or claims therefor become due, and to save and protect the Project, the Owner, and the Contractor from all claims and mechanics' liens on account thereof, and to *furnish satisfactory evidence to the Contractor when and if required*, that he has complied with the above requirements. This provision shall not be construed as a waiver of the right of the Subcontractor to file and enforce a lien claim as against the Owner in the event of the Contractor's failure to pay the Subcontractor.

(Emphasis added.)

Clause F of the subcontract provided:

> If notification of any claims have been made against the Subcontractor or the Contractor arising out of labor or materials furnished the Project or otherwise on account of any actions or failures to act by the Subcontractor in the performance of this Subcontract, the Contractor may, at his discretion, withhold such amounts otherwise due or to become due hereunder to cover said claims and any costs or expenses arising or to arise in connection therewith pending legal settlement thereof. This right of the Contractor shall not be exclusive of any other rights of the Contractor herein or by law provided.

Four subcontractors of Fiberglass filed liens on the project. On March 28, 1978, Fiberglass filed in bankruptcy court for an arrangement under Chapter XI of the Bankruptcy Act of 1898.[1] Pursuant to rule 11-44, an automatic restraint on any actions against the debtor and its property became effective. On April 3, 1978, the bankruptcy court restrained every action and proceeding against Fiberglass and its property. On May 18, 1978, Fiberglass notified Bor-Son of the filing and demanded payment of the funds retained by Bor-Son. On September 18, 1978, Fiberglass commenced an action in bankruptcy court to recover the funds retained by Bor-Son.

On September 29, 1978, Bor-Son notified Fiberglass that certain doors installed by Fiberglass had to be replaced. Bor-Son told Fiberglass that the doors were defective and that they were covered by Fiberglass' warranty. Fiberglass took no steps to correct the defect and Bor-Son had the work done and backcharged Fiberglass. The amount expended to replace the doors was $3,872.00

On October 16, 1978, Bor-Son informed Fiberglass that all subcontractors would be paid by Bor-Son if they were not paid by Fiberglass prior to October 23, 1978. In October and November of 1978, Bor-Son, without obtaining the permission of the bankruptcy court, paid all claimants who filed liens on the Estherville project, payments totaling $62,112.72. Among the payments allegedly made was a payment to Crewmasters of $29,526.12.

On May 29, 1979, Bor-Son filed a claim for $66,184.12 against Fiberglass in bankruptcy court. Thereafter, on June

[1] The 1898 act rather than the Bankruptcy Act of 1978, which became effective on October 1, 1979, governs this case. *See* Pub. L. No. 95-598, 92 Stat 2549, 2682 (1978).

5, 1978, Crewmasters filed a claim for $29,456.22 against Fiberglass in bankruptcy court.[2]

The bankruptcy judge found Bor-Son liable to Fiberglass for the amount retained by Bor-Son under the subcontract. The judge concluded that all but one of the payments Bor-Son had made to Fiberglass' subcontractors benefited the debtor's estate. He allowed Bor-Son to deduct $34,703.13 from the retainage fund. However, the bankruptcy judge refused to allow a deduction for the payment to Crewmasters. The judge found that Fiberglass had already paid Crewmasters the $29,526.12. Judgment was thereafter rendered against Bor-Son and in favor of Fiberglass for $31,488.18 plus interest. The parties consented to have the case reviewed by a United States Magistrate. The magistrate affirmed the order of the bankruptcy court in all respects. Bor-Son appeals.

Issues.

Bor-Son contends that the retained money was not Fiberglass' property and thus that it did not violate an order of the bankruptcy court by paying the lien holders. Bor-Son also urges that even if the retainage is Fiberglass' property, Bor-Son is entitled to set off the payment to Crewmasters. Bor-Son argues that it was prejudiced by Fiberglass' failure to plead payment as an affirmative defense to Bor-Son's counterclaim. It also claims that Fiberglass must bear the loss of any alleged prior payment because of principles of (1) negligence, (2) estoppel, (3) ratification, (4) indemnity, and (5) restitution. In addition, Bor-Son contends that there was insufficient competent evidence to support a finding of overpayment to Crewmasters and that under the law of application of payments Fiberglass cannot recover the amount Bor-Son

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[2] Crewmasters did not appear at trial and the bankruptcy court expunged its claim.

paid to Crewmasters. Finally, Bor-Son contends it is not liable for interest paid to Fiberglass' subcontractors.

Jurisdiction.

Bor-Son alleges the retained funds were not Fiberglass' property. Although Bor-Son does not directly raise the issue, this allegation requires us to examine the bankruptcy court's jurisdiction to adjudicate the claim. Section 311 of the Bankruptcy Act provides:

> Where not inconsistent with the provisions of this chapter, the court in which the petition is filed shall, for the purposes of this chapter, have exclusive jurisdiction of the debtor *and his property*, wherever located.

11 U.S.C. § 711 (1979) (emphasis added).

The bankruptcy court cannot assert jurisdiction over a res in which the debtor does not have a property interest.

The bankruptcy court has jurisdiction over property in the actual and constructive possession of the debtor. It is well settled that property held by another is not in the constructive possession of the debtor if there is a substantial adverse claim to the property. *Harrison v. Chamberlin*, 271 U.S. 191, 195 (1926); *Bradley v. St. Louis Terminal Warehouse Co.*, 189 F.2d 818, 824 (8th Cir. 1951). This analysis has been applied to choses in action held by the bankrupt. *See Willyerd v. Buildex Co.*, 463 F.2d 996, 999-1000 (6th Cir. 1972); *In re Lehigh Valley Railroad Co.*, 458 F.2d 1041, 1043-44 (3rd Cir. 1972); *In re Co-Build Companies, Inc.*, 408 F. Supp. 717 (E.D. Pa. 1976).[8]

In this case, we must decide if Fiberglass held a property interest under the Bankruptcy Act in the fund retained by

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[8] If an obligor admits the obligation to the bankrupt and its amount, the bankruptcy court may exercise jurisdiction over the property immediately. *See In re Lehigh Valley Railroad Co.*, 458 F.2d 1041, 1044 (3rd Cir. 1972).

Bor-Son. If Fiberglass simply had a contractual cause of action, Fiberglass or the trustee in bankruptcy can only enforce the contract in a court of general jurisdiction. *See In re Standard Gas & Electric Co.*, 119 F.2d 658, 661-62 (3d Cir. 1941); 4A Collier on Bankruptcy ¶ 70.28[1], at 389 (J. Moore and L. King 14th ed. 1978).

Other federal courts which have confronted this issue have held that the bankrupt subcontractor has only a cause of action under the subcontract which must be enforced in a court of general jurisdiction. *See Green v. H. E. Butt Foundation*, 217 F.2d 553 (5th Cir. 1954); *In re H. L. Gentry Construction Co.*, 200 F. Supp. 546 (E.D. Mich. 1961), *aff'd*, 314 F.2d 945 (6th Cir. 1963); *cf. Bayview Estates, Inc. v. Bayview Estates Mobile Homeowners Association*, 508 F.2d 405 (6th Cir. 1974) (rent held in escrow); *In re Wiltse Brothers Corp.*, 357 F.2d 190 (6th Cir. 1966) (bankruptcy court had jurisdiction because no liens filed against project); *Polish v. Johnson Service Co.*, 333 F.2d 545 (3d Cir. 1964) (retained fund does not vest in bankruptcy trustee under section 70a). *But see Butler v. Pacific National Insurance Co.*, 375 F.2d 518 (9th Cir. 1967) (fund retained by state pursuant to statute).

We find the money retained by Bor-Son is not Fiberglass' property. Bor-Son was not in the position of a trustee or bailee. Bor-Son retained the money under a claim of right arising from clause F of the subcontract. *See Willyerd v. Buildex Co.*, 463 F.2d 996, 999-1000 (6th Cir. 1972) (no jurisdiction to enforce payment under construction contract when breach alleged). At the time the bankruptcy petition was filed, Fiberglass' right to the funds was not undisputed and had not been established. Almost 60 years ago, Justice Brandeis described the nature of a contract creditor's claim against his debtor:

> [A]n unsecured simple contract creditor has, in the absence of statute, no substantive right, legal or equitable, in or to the property of his debtor. This is true, whatever the nature of the property; and, although the debtor is a corporation and insolvent. The only substantive right of a simple contract creditor is to have his debt paid in due course.

Pusey & Jones Co. v. Hanssen, 261 U.S. 491, 497 (1923).

We conclude that Fiberglass possessed merely a chose in action against Bor-Son and that the bankruptcy court therefore lacked jurisdiction to adjudicate the parties' respective rights to the retained funds.[4] We thus reverse and remand the case to the district court with direction to vacate the order of the bankruptcy court for lack of jurisdiction.

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[4] Because we find that the bankruptcy court lacked jurisdiction to hear this case, we need not address the substantive issues raised by Bor-Son.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT
September Term 1981
No. 81-1647

In Re:

FIBREGLASS SPECIALTY CO., INC.,

Appellee,

vs.

BOR-SON CONSTRUCTION, INC.,

Appellant.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MINNESOTA

Petition of appellee for rehearing filed in this cause having been considered, it is now here ordered by this Court that the same be, and it is hereby, denied.

June 21, 1982.

Office - Supreme Court, U.S.
FILED
OCT 30 1982
ALEXANDER L. STEVAS,
CLERK

No. 82-539

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

FIBERGLASS SPECIALTY COMPANY, INC.,
Petitioner,

v.

BOR-SON CONSTRUCTION, INC.,
Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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QUESTION PRESENTED FOR REVIEW

Did the bankruptcy court have jurisdiction under the Bankruptcy Act of 1898 to adjudicate the respective rights of a bankrupt subcontractor and a general contractor over money retained by the general contractor under their subcontract agreement?

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APPLICABLE STATUTORY PROVISION

United States Supreme Court Rule 17

Rule 17. Considerations Governing Review on Certiorari

.1. A review on writ of certiorari is not a matter of right, but of judicial discretion, and will be granted only when there are special and important reasons therefor. The following, while neither controlling nor fully measuring the Court's discretion, indicate the character of reasons that will be considered.

(a) When a federal court of appeals has rendered a decision in conflict with the decision of another federal court of appeals on the same matter; or has decided a federal question in a way in conflict with a state court of last resort; or has so far departed from the accepted and usual course of judicial proceedings, or so far sanctioned such a departure by a lower court, as to call for an exercise of this Court's power of supervision.

* * *

(c) When a state court or a federal court of appeals has decided an important question of federal law which has not been, but should be, settled by this Court, or has decided a federal question in a way in conflict with applicable decisions of this Court.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982
No. 82-539

FIBERGLASS SPECIALTY COMPANY, INC.,
Petitioner,

v.

BOR-SON CONSTRUCTION, INC.,
Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

The undersigned respondent respectfully requests the Court to deny the Petition for a Writ of Certiorari to review the judgment, entered June 21, 1982, in the United States Court of Appeals for the Eighth Circuit.

STATEMENT OF THE CASE

The dispute involved in this case arose from a construction subcontract entered into on June 29, 1979, by Bor-Son Construction, Inc. ("Bor-Son") as contractor and Fiberglass Specialty Company, Inc. ("Fiberglass") as subcontractor. Fiberglass agreed to furnish all labor, material, skill and equipment

necessary to erect circular tank covers for a water pollution control facility in Estherville, Iowa, for a total contract price of $443,000.00. Fiberglass, in turn, subcontracted with Crewmasters, Inc. ("Crewmasters") to provide labor for the installation of these tank covers. These tank covers were installed between March 1977 and November 1977.

Shortly after the work was completed, several subcontractors of Fiberglass filed liens on the project arising out of work done for Fiberglass. In order to protect itself against such lien claims, Bor-Son retained $66,191.31 pursuant to clause F of the subcontract with Fiberglass.

On March 28, 1978, Fiberglass petitioned for an arrangement under Chapter XI of the Bankruptcy Act of 1898 in the Bankruptcy Court for the District of Minnesota. On April 3, 1978, the bankruptcy court restrained every action and proceeding against Fiberglass and its property. Fiberglass notified Bor-Son of its filing in the bankruptcy court on May 18, 1978, and demanded that Bor-Son pay over the funds retained on its subcontract. Finally, on September 18, 1978, Fiberglass commenced an action in the bankruptcy court to recover the funds retained by Bor-Son.

On October 11, 1978, Bor-Son served its Answer and Counterclaim to Fiberglass' Complaint in the bankruptcy court. Bor-Son's Sixth Defense, paragraph XXVII, read as follows:

> The sum of $66,191.31, which is alleged by plaintiff in its Complaint to be due and owing, has not become a part of the bankruptcy estate and its disposition is not controlled by the Bankruptcy Act pursuant to *Pearlman v. Reliance Insurance Co.*, 371 U.S. 132 (1962), and its progeny.

Bor-Son argued throughout the proceedings, before the bankruptcy court, the United States Magistrate and the Court of

Appeals for the Eighth Circuit, that the retained funds were not the property of Fiberglass under the *Pearlman* doctrine.

On October 16, 1978, Bor-Son informed Fiberglass that unless Fiberglass satisfied the claim of Crewmasters and the other lien claimants by October 23, 1978, Bor-Son would satisfy the claims and backcharge Fiberglass' account. Receiving no response from Fiberglass, Bor-Son settled and obtained releases for all the claims and liens filed by Fiberglass' subcontractors and suppliers on November 22, 1978. Among the payments made was a payment to Crewmasters in the amount of $29,526.12.

The bankruptcy court found Bor-Son liable to Fiberglass for the amount retained by Bor-Son under the subcontract. The bankruptcy court concluded that all of the payments, except the payment to Crewmasters, benefited the debtors estate and allowed Bor-Son to deduct these payments from the retainage fund. The bankruptcy court refused, however, to allow a deduction for the payment to Crewmasters. The parties consented to have the case reviewed by a United States Magistrate and the magistrate affirmed the order of the bankruptcy court in all respects.

Bor-Son then appealed the decision to the United States Court of Appeals for the Eighth Circuit. The Eighth Circuit concluded that Bor-Son's argument that the retained funds were not Fiberglass' property required it to examine the bankruptcy court's jurisdiction to adjudicate the claim. The court found that the money retained by Bor-Son was not Fiberglass' property and that the bankruptcy court lacked jurisdiction to adjudicate the parties respective rights to the retained funds. The Eighth Circuit reversed and remanded the case to the district court with the direction to vacate the order of the bankruptcy court for lack of jurisdiction.

ARGUMENT

I. Fiberglass Has Not Presented Any Special and Important Reasons, Consistent with Rule 17, to Convince This Court to Exercise Its Discretion and Grant Fiberglass' Writ of Certiorari.

United States Supreme Court Rule 17 outlines the considerations governing review on writs of certiorari. The Rule begins by noting that a writ of certiorari is not a matter of right and will only be granted when there are "special and important reasons". Justice Frankfurter once commented that "special and important reasons" implies a "reach to a problem beyond the academic or the eposodic". *Rice v. Sioux City Memorial Park Cemetery, Inc.*, 349 U.S. 70, 74 (1955). While a federal question raised by a writ of certiorari may present an intellectually interesting and solid problem, this Court does not sit to satisfy a scholarly interest in such issues. *Id.* The instant case does not present any special and important reasons requiring review; indeed, review would be academic in light of the new Bankruptcy Act of 1978.

A. The Question of Federal Law Decided by the Court of Appeals Under the Repealed 1898 Bankruptcy Act Is Not an Important Question Justifying Review.

Supreme Court Rule 17.1(c) provides in part that where an important question of federal law has not been, but should be, settled by this Court, the Court may grant review on writ of certiorari. Justice Harlan remarked that "the cornerstone of a petition for certiorari in a federal case is a showing that the question to be reviewed is one of *general* importance." *Manning the Dikes*, 13 Rec. N.Y.C.B.A. 541, 551 (1958) (em-

phasis in the original). The importance of an issue is not measured by its impact on the litigants, but on its contribution to the development of national law. *See* 13 Moore's *Federal Practice* ¶ 817.41, at SC17-38 (2d ed. 1982). Several commentators have noted that where the issue sought to be reviewed concerns a statute that has been repealed, absent special circumstances, the issue does not merit consideration by this Court. *See id.* at SC17-43; R. Stern & E. Gressman, *Supreme Court Practice* §4.4, at 266, 270-71 (5th ed. 1978).

Obviously, the present case falls into the category envisioned by these commentators. The Bankruptcy Act of 1898 has been repealed and replaced by the Bankruptcy Act of 1978. This case does not present an important question of federal law since it is an interpretation of a statute that does not apply to future cases. This court has consistently refused to grant writs of certiorari in such cases. *See District of Columbia v. Sweeney*, 310 U.S. 631 (1940); Stern, *Denial of Certiorari Despite a Conflict*, 66 Harv. L. Rev. 465, 466-67 (1953) (discussing *United States v. Abrams*, 344 U.S. 855 (1952); *Community Services, Inc. v. United States*, 342 U.S. 932 (1952); *Sokol Bros. Furniture Co. v. Commissioner*, 340 U.S. 952 (1951); *United States v. Beal*, 340 U.S. 852 (1950)).

B. The Court of Appeals Did Not Depart From the Accepted and Usual Course of Judicial Proceedings.

Supreme Court Rule 17.1(a) provides in part that when a federal court of appeals has so far departed from the accepted and usual course of judicial proceedings, review on writ of certiorari may be appropriate. This provision in Rule 17 relates to the Court's supervisory capacity and allows for relief similar to that which can be obtained through a writ of mandamus. *See* 13 Moore's, *supra*, ¶ 817.27.

This provision permits the Court to grant certiorari to remedy conduct that would not merit the use of the extraordinary writ of mandamus. The cases in which the Court has granted certiorari under this provision are of a unique type unlike the present case. *See, e.g., New York City Transit Authority v. Beazer*, 440 U.S. 568 (1979) (writ of certiorari granted to correct decision by court of appeals deciding constitutional issue before statutory issue); *Thermtron Products, Inc. v. Hermansdorfer*, 423 U.S. 336 (1976) (writ of certiorari granted to correct remand by federal district court which had remanded case on grounds that its docket was overburdened).

C. There Is No Real or Embarrassing Conflict With Decisions of This Court, Other Federal Courts of Appeals, or the State Courts of Last Resort.

The remaining provisions in Rule 17 allow for review by writ of certiorari when a federal court of appeals' decision conflicts with either applicable decisions of this Court, decisions of a state court of last resort or decisions of other federal courts of appeals. Since state courts of last resort do not interpret federal bankruptcy laws, that reason for review cannot be present in this case.

Old Supreme Court Rule 38(5)(b) of the 1939 Rules required only a showing that the decision of the court of appeals was "probably" in conflict with applicable Supreme Court decisions. The dropping of the word "probably" indicates that a conflict with applicable Supreme Court decisions must be direct and irreconcilable. *See* R. Stern & E. Gressman, *supra*, §4.5, at 273. Petitioner Fiberglass has cited no decisions of this Court that meet this criteria.

Chief Justice Taft, in *Layne & Bowler Corp. v. Western Well Works, Inc.*, 261 U.S. 387, 393 (1923), stated that this

Court should grant writs of certiorari only in cases where there is a "real and embarrassing conflict of opinion and authority between the Circuit Courts of Appeals." And Justice Harlan stated that "even where a 'true' conflict may be said to exist, certiorari will sometimes be denied . . . where the impact of the conflict is narrowly confined and is not apt to have continuing future consequences, as where a statute which has given rise to conflicting interpretations has been repealed or is about to expire". *Some Aspects of the Judicial Process in the Supreme Court of the United States*, 33 Aust. L. J. 108 (1959); *see* R. Stern & E. Gressman, *supra*, §4.4, at 266; 13 Moore's, *supra*, ¶ 817.21, at SC17-22.

Although Petitioner Fiberglass asserts that the Eighth Circuit decision is in conflict with other decisions of the federal courts of appeal, it does not cite or discuss any such cases. Indeed, several federal courts have decided this question in accord with the decision of the Eighth Circuit. *E.g., Green v. H. E. Butt Foundation*, 217 F.2d 553 (5th Cir. 1954); *In re H. L. Gentry Construction Co.*, 200 F. Supp. 546 (E. D. Mich. 1961), *aff'd*, 314 F.2d 945 (6th Cir. 1963); *see* discussion *infra*. The only decision by a federal court that conflicts in any way whatsoever with the decision by the Eighth Circuit is *Butler v. Pacific National Insurance Co.*, 375 F.2d 518 (9th Cir. 1967). This decision, however, while reaching the conclusion that retainage on a contract with a bankrupt debtor is the debtor's property, holds that such retainage must be applied first to any lien claims, pursuant to *Pearlman v. Reliance Insurance Co.*, 371 U.S. 132 (1962). The result of this decision is thus in accord with the decision of the Eighth Circuit and does not present the "real or embarrassing conflict" that requires review on writ of certiorari. This is particularly true in light of the fact that the Bankruptcy Act of 1898 has been repealed.

II. The Bankruptcy Court Lacked Jurisdiction to Adjudicate the Parties' Respective Rights to the Retained Funds.

A. The Decision of the Court of Appeals That the Bankruptcy Court Lacked Jurisdiction Is Consistent With Decisions by Other Federal Courts.

Petitioner Fiberglass attempts to draw a distinction between a bankruptcy court's subject matter jurisdiction and a bankruptcy court's summary jurisdiction under the Bankruptcy Act of 1898. This is a distinction without a difference in that proceedings in bankruptcy under the 1898 Act are essentially summary, as opposed to plenary, in nature. *See Willyerd v. Buildex Co.*, 463 F.2d 996, 999 (6th Cir. 1972). It is well settled under the 1898 Act that a court of bankruptcy is without jurisdiction to adjudicate a controversy in reference to property held adversely to the bankrupt estate; in such a case, resort must be had by the bankrupt's trustee in a plenary suit. *See Harrison v. Chamberlin*, 271 U.S. 191, 193 (1926). If there is a substantial dispute as to whether property is property of the debtor, then the trustee in bankruptcy must resort to a plenary action in a court that has personal jurisdiction over the adverse claimant in order to establish the property as an asset subject to the jurisdiction of the bankruptcy court. *See In re Lehigh Valley R.R.*, 458 F.2d 1041, 1044 (3rd Cir. 1972); *In re Co-Build Co.*, 408 F. Supp. 717, 720 & n.4 (E.D. Pa. 1976).

The leading case that sets forth the test for determining whether a bankruptcy court has summary jurisdiction under the 1898 Act is *Harrison v. Chamberlin*, 271 U.S. 191 (1926). That decision instructs the bankruptcy court to enter into a preliminary inquiry to determine whether an adverse claim to property is real and substantial or merely colorable. *Id.* at

194. If the bankruptcy court finds that the adverse claim is merely colorable, the court may then proceed to adjudicate the merits summarily. If, however, the bankruptcy court finds the adverse claim to be real and substantial, it must then decline to determine the merits and must dismiss the summary proceedings. *Id.*

In *In re Standard Gas & Electric Co.*, 119 F.2d 658, 661 (3rd Cir. 1941), the Third Circuit noted that in a broad sense the claim by a debtor against a third person is property of the debtor. But the court went on to say that such a claim is a species of property which may only be realized for the benefit of the debtor and its creditors by the successful prosecution of a plenary suit against the third persons involved. *Id.* at 661-62. The Third Circuit concluded that the jurisdiction which is exercised by courts of bankruptcy in summary form has uniformly been held to extend only to the person of the bankrupt and to property in his possession, *or in the possession of third persons who do not claim adversely to him or whose claims are colorable only. Id.* at 661.

At least two federal courts have directly addressed the issue of the bankruptcy court's jurisdiction over a retainage fund held by a third person adverse to the bankrupt under the Bankruptcy Act of 1898. In *Green v. H. E. Butt Foundation*, 217 F.2d 553, 554 (5th Cir. 1954), the Fifth Circuit held that a retainage fund is not a debt due to the bankrupt and does not fall into the hands of the trustee under the bankruptcy's court summary jurisdiction. The court found that liens of mechanics and materialmen, created prior to the filing of a petition in bankruptcy, appropriate the retained fund to the extent necessary to satisfy the indebtedness due such lienors. *Id.* The court stated that a trustee in bankruptcy has a right to bring a plenary action in a court of competent

jurisdiction against the third person holding the retained fund, but the trustee is not entitled to a summary order by the bankruptcy court transferring the funds to the trustee. *Id.*

The district court in *In re H. L. Gentry Construction Co.*, 200 F. Supp. 546 (E. D. Mich. 1961), *aff'd*, 314 F.2d 945 (6th Cir. 1963), also addressed the question of a bankruptcy court's jurisdiction over a retainage fund held by a third person adverse to a claim by a bankrupt under the 1898 Act. The district court held that the bankrupt contractor had no property interest in the retainage fund and that the bankruptcy court was thus deprived of summary jurisdiction. *Id.* at 550. The court relied on *Harrison v. Chamberlin*, 271 U.S. 191 (1926), for its conclusion that the bankruptcy court lacked jurisdiction to require the third party to turn over the retainage fund to the bankruptcy court. The court also held that the bankruptcy court had no jurisdiction to determine the validity of claims against a fund which is not subject to its jurisdiction. *Id.* at 552.

One federal court, however, has held that a retainage fund held by a third party is the property of the bankrupt within the meaning of the Bankruptcy Act of 1898. *See Butler v. Pacific National Insurance Co.*, 375 F.2d 518, 521 (9th Cir. 1967). Nonetheless, the court in that case, relying on *Pearlman v. Reliance Insurance Co.*, 371 U.S. 132 (1962), held that there was no right in the bankrupt's estate to the withheld funds until the lien claimants against the fund had been paid. *Id.* at 520. Thus the result is not contrary to the decision in the present case.

Consistent with the decisions in the preceding cases, the Eighth Circuit has concluded that a bankruptcy court lacks jurisdiction over a retainage fund held by a third person adverse to the bankrupt under the Bankruptcy Act of 1898.

Since the Eighth Circuit concluded that the retained money was not Fiberglass' property, it was correct in holding that the bankruptcy court lacked jurisdiction to adjudicate the parties' respective rights to the retained funds.

B. Bor-Son Did Not Waive Its Objection to the Jurisdiction of the Bankruptcy Court.

Throughout the proceedings in this case, Bor-Son consistently and strenuously argued that the retained funds were not the property of Fiberglass. Bor-Son has argued extensively that the doctrine of *Pearlman v. Reliance Insurance Co.*, 371 U.S. 132 (1962), governs the disposition of this case and supports its claim that the retained funds were not the property of Fiberglass.

Fiberglass places heavy reliance on the decision in *In re Murray*, 94 F.2d 612 (7th Cir. 1937), for its argument that a party can waive its objections to the lack of summary jurisdiction of a bankruptcy court. The case before the Seventh Circuit in *In re Murray*, however, varies in an important respect with the present case. In *In re Murray* the third party consented to the summary jurisdiction of the bankruptcy court by voluntarily conveying the property in question to the trustee in bankruptcy after the trustee made demand for the property and prior to the adjudication by the bankruptcy court. In the present case, Bor-Son has consistently refused to pay over the retainage to the bankruptcy trustee.

CONCLUSION

Fiberglass in its Petition for Writ of Certiorari has failed to present any special and important reasons that can convince this Court to exercise its discretion and grant the writ of certiorari. In particular, there is no important question of federal law that needs to be decided by this Court in light of the repeal of the Bankruptcy Act of 1898. Nor is there any real or embarrassing conflict between the decision of the Eighth Circuit and any other federal court including this Court.

The holding by the Eighth Circuit that the bankruptcy court lacked jurisdiction is correct and in accord with other decisions by the federal courts. Further, Bor-Son never waived its objection to the summary jurisdiction of the bankruptcy court.

Respondents respectfully submit that the Petition for Writ of Certiorari should be denied.

Dated: October 18, 1982

Respectfully submitted,

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